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## DIGITAL ASSETS:

### ELECTRONIC TRADE DOCUMENTS

#### A. Introduction

1. The City of London Law Society ("CLLS") represents approximately 17,000 City solicitors through individual and corporate membership including some of the largest international law firms in the world. Its specialist Committees comprise leading solicitors in their respective fields. These solicitors and their law firms operating in the City of London act for UK and international businesses, financial institutions and regulatory and governmental bodies in relation to major transactions and disputes, both domestic and international.
2. The Financial Law Committee of the City of London Law Society (the **Committee**) has formed a working group (the **Working Group**) to consider and respond to the Law Commission's "Digital assets: Call for Evidence" (the **CE**) and Consultation Paper on "Digital assets: electronic trade documents" (the **CP**). The CE and CP together form the Law Commission's current project on digital assets, including cryptoassets. We refer to the CE and CP collectively, therefore, as the **Digital Assets Papers**.
3. This paper deals specifically with issues related to the CP on Electronic Trade Documents, but should be read in conjunction with our separate response on the limits of the concept of "possession" (attached) with particular reference to our experience of existing solutions supporting digital assets projects in the wider financial markets. This paper addresses those questions raised in the consultation on which the Committee and Working Group believe they can usefully contribute and comments on the draft legislation appended. We very much welcome the initiative of the Law Commission to enable the use of electronic trade documents. Our observations on approach should not be viewed negatively, but are intended to be constructive in producing a working system in the immediate future without causing issues of confusion with other dematerialised systems already in existence and addressing the concerns financiers will have with the new system when they are asked to provide finance. We also touch on some potential regulatory concerns.

## Questions and Responses

Consultation Question 1.

8.1 We invite consultees' views on the advantages and disadvantages associated with using private contractual frameworks to facilitate the use of electronic trade documents, compared with using electronic documents recognised in law as being equivalent to paper documents.

#### Paragraph 2.44

The principal advantages of officially recognised contractual or other legal frameworks for dematerialisation processes (which replicate rights in the paper environment, whether through an "equivalence" approach or otherwise) are:

Confidence levels arising from regulatory oversight;

Strong, clear and well-founded legal basis, often legislative, in the relevant jurisdiction;

Accountability of the system operator;

Considerable reduction in the risks of fraud associated with transactions in the system related to interests recorded in the system; and

Increased opportunities for international recognition.

These can arise with public or private systems, including the authorisation of multiple systems where appropriate.

The advantages of recognition of certain electronic documents as a type as equivalent to paper documents is flexibility and lack of cost, but carries disadvantages in relation to the other matters mentioned above.

We note that, apart from simple contracts and deeds executed to a certain standard, the dematerialisation of assets that constitute paper documents has taken the form of electronic systems which register the person or persons entitled to deal with the assets represented by each entry in the system. The question whether that person deals as owner or in some other capacity (eg trustee, agent, holder of debt secured on the asset) is irrelevant to the system.

In the absence of any requirement for a system, authenticated means of execution or other test to establish the right to deal etc, it seems difficult to see how fraud (where the fraudster deals ahead of the person genuinely entitled to do so) or confusion between persons interested in different capacities would be avoided. Electronic documents are likely to be capable of being readily duplicated by electronic means, which is why a register of record or other process of authentication is a key element of developments in this field.

Protections needed in this regard are likely to include at least some standards for the systems of record, possibly with regulatory oversight, as well as clear application of money laundering, anti-terrorism and data protection rules. Whether a system would fall within existing financial regulatory rules would depend on the nature of the documents included and/or whether the system is operated by a regulated institution.

We note that the Law Commission's proposals do not provide any safeguards in these regards. The systems referred to by the Law Commission in the CP were no doubt established to provide users with those safeguards.

Consultation Question 2.

8.2 We provisionally propose that our reforms cover only the following categories of document:

- (1) bills of exchange;
- (2) promissory notes;
- (3) bills of lading;
- (4) ship's delivery orders;
- (5) warehouse receipts;
- (6) marine insurance policies; and
- (7) cargo insurance certificates.

Do consultees agree? If not, we invite consultees to suggest categories of document that should be added to or removed from this list, and to explain why.

#### Paragraph 3.85

We agree that the documents covered should be limited to those commonly used as negotiable instruments in the context of international trade in goods.

We note that bills of exchange and promissory notes have uses in the financial markets outside of the field of international trade in goods. For example, certain instruments which are technically of these types are used in the money markets and may be dealt with under the arrangements created for "eligible debt securities" by the Uncertificated Securities (Amendment)(Eligible Debt Securities) Regulations 2003. Such instruments entered in a "relevant system" under the Uncertificated Securities Regulations 2001 should be excluded from the provisions of legislation dealing with trade documents.

Consideration should be given as to whether other categories of bills of exchange or promissory note should be excluded, and indeed whether these categories of documents should be included in the proposal at all. They are essentially negotiable evidence of an obligation to pay money, not associated with the underlying asset. We understand that international trade in goods uses various types of payment and financing methodology, with these historically important means of payment increasingly being replaced by others. We think it would reduce the issues related to fraud considerably to remove these categories from the proposal, particularly if the proposals are to be enacted without any requirement for a regulated system of record (or at least a requirement for minimum standards and characteristics).

#### Consultation Question 3.

8.3 We provisionally propose that sea waybills and air waybills need not and should not be included. Do consultees agree?

### Paragraph 3.86

Assuming these documents are only used in the ways understood by the Law Commission, we agree with this conclusion. We do note that a number of other countries have included at least sea waybills in their legislation on electronic documents, which suggests that their inclusion may have some use in relation to trade with some countries, which may treat a waybill as a key document in relation to disposal of the underlying goods. If that is the case, there could be value in including waybills in the list.

### Consultation Question 4.

8.4 We provisionally propose that bearer bonds and other documents of title including banker's drafts, certificates of deposit payable to bearer, bearer scrip certificates exchangeable for shares, mate's receipts, traveller's cheques, and dividend warrants need not and should not be included. Do consultees agree?

### Paragraph 3.87

We strongly agree. With the exception of mate's receipts, none of these documents are primarily used in relation to trade in goods. We note that, although bearer bonds are widely issued as a means of financing, market practice, in response to fraud and other relevant operational risk considerations, is that the global bond is held for safekeeping and administration by or for a common depository on behalf of Euroclear Bank and/or Clearstream Bank (as ICSDs).

Entitlements/right to deal are evidenced by entries in a registry, maintained by the relevant ICSD, with smaller interests generally evidenced by entries in the records maintained by intermediaries, as a form of intermediated security. Given existing regulatory requirements we do not think these forms of instrument are suitable for the proposed treatment.

In practice interests of these types (other than mate's receipts) are already capable of being safely, efficiently and effectively dealt with electronically and inclusion in these schemes would simply cause anomalies and confusion. At a policy level, we note that UK companies are prohibited from issuing bearer shares (Small Business Enterprise and Employment Act 2015), so as to ensure transparency in ownership of companies. The Bearer Certificates (Collective Investment Schemes) Regulations 2020 (2020 NO 1346) at Regulation 241 also prohibits the issuance of bearer units in collective investment schemes. It also cut off issue of bearer shares by OEICS authorised before 26 June 2017 after end 2020, by amendment of Regulation 48 of the OEICS Regulations 2001.

### Consultation Question 5.

8.5 We provisionally propose that the Secretary of State should have the power to add, remove, or amend an entry in the list of documents described in Consultation Question 1 by regulations made by statutory instrument. Do consultees agree?

### Paragraph 3.88

We agree.

### Consultation Question 6.

8.6 We provisionally propose that the group of documents covered by our proposed reforms should be referred to as "trade documents" in the draft Bill. Do consultees agree?

If not, what alternative label would consultees propose, and why?

### Paragraph 3.94

We agree, as we believe this proposal should be strictly limited to documents used in relation to trade in goods.

Consultation Question 7.

8.7 We provisionally propose that each individual trade document in the draft Bill need not and should not be defined. Do consultees agree? If not, please give reasons.

Paragraph 3.96

We think that is probably unnecessary for the purposes of English law. We cannot comment on the position if the proposals will apply in Scotland.

We do think it needs to be clarified whether trade documents governed by other systems of law are to be treated in the same way as those governed by English law. We note that trade is an area where customary documents are frequently used without a specific choice of law in an international context where other indicators of the governing law may be unclear or finely balanced, leading to costly litigation. There would be an advantage in addressing this point up-front. We note that this would be less of a problem in the event that electronic documents were required to be entered into an approved registry or other system and deemed, in the absence of express choice, to be most closely connected with the system of law governing the rules of the relevant registry or system.

Consultation Question 9.

8.9 We provisionally propose that bare legal rights should be excluded from the scope of our proposals for the possession of electronic trade documents. Do consultees agree?

Paragraph 5.58

We agree, but see our comments on the concept of deemed possession of dematerialised documents.

Consultation Question 10.

8.10 We provisionally propose that, in order for an electronic trade document to be capable of possession, the nature of the document must not support concurrent control by multiple parties at one time. Do consultees agree?

Paragraph 5.72

If the concept of deemed possession is to be used in relation to trade documents, then this becomes an issue. If a registration system is used, the rules of the system will determine how many persons can be identified on the register and whether the first named or all or a majority are needed to give instructions, so as to deal with the registered electronic document and transfer it into the control of another person. It is different from the position with a paper document where the physical individual presenting the document effectively can transfer it without any regard to the type of interest (if any) he or she may have in the underlying goods (the individual will rarely have any interest and even his or her employer may not). The holder has legal title and other interests (which English law would characterise as of an equitable nature) are dealt with in the contractual arrangements behind the scenes.

Once an electronic system is used the identification of an individual who can prove the right to deal becomes more problematic. This is where the use of an electronic registry or other system of record enables issues of authentication to be addressed. While a physical trade document may be presented by an individual, the registered holder is perhaps more likely to be a corporate entity

who will normally have a number of authorised representatives. Either these would be identified to the system (with requirements for one or two signatories to give instructions) or their employer would give each of them access to the means individually to deal with the electronic document. Some systems would favour the former approach, while the latter would be effective for DLT systems, but would make the private key (or the device holding it) a new element in the control of the electronic document with potentially a separate physical presence in a different location to the system: and that place might be different from that where an equivalent physical trade document would be located. Either way, it is likely that the role of the individual as the ostensible holder will be reduced.

Once some approved system is needed for an authentication service, it seems to us it is not necessary to the use of electronic documents to have the concept of deemed possession. The right to deal is a product of the system's rule relating to the holding, transfer and presentment of the electronic document - it does not need to depend on possession. It also reduces issues related to location, although these remain important.

Consultation Question 11.

8.11 We provisionally propose that "control" should be defined as the ability (as a matter of fact) to:

- (1) use; and
- (2) transfer or otherwise dispose of

an electronic trade document. Do consultees agree?

Paragraph 5.90

We see that evidential issues could be significant in the absence of any process of authentication of both the relevant individual and one or more persons (real or legal) that are instructing the individual. Guidance from those active in dealing with trade documents, such as bills of lading would be essential to determining how practical this proposal is.

We also have concerns, by reference to the example contained in paragraphs 43 to 46 of the UKJT Legal Statement, that under certain DLT systems while "control" (as the Law Commission seeks to define it above) is "generally" vested in the person(s) who have acquired knowledge and control of the private key upon a transfer (but prior to entry of the transferee on the DLT ledger), it remains possible for the transferor that remains entered on the ledger to effect a subsequent transfer or other disposal of (i.e. "double spend") the relevant digital assets (prior to the actual validation and recording of the first transfer in the system). This point underscores, in our mind, the difficulty in practice of providing a comprehensive and effective definition of "control" with respect to electronic trade documents and other digital assets in all types of system.

We suspect that, with particular reference to the use of "multi-signature" wallets and similar technological developments affecting the holding and transfer of digital assets, it will be necessary to provide a much more nuanced definition of "control" (perhaps supported by statutory guidance) if the Law Commission's proposals in this area are to have practical value and remain capable of responding adequately to market developments for trade finance or DLT and other electronic technologies underpinning the use of ETDs.

Consultation Question 12.

8.12 We provisionally propose that, in order for an electronic trade document to be capable of possession, “the system” on which the document is held must ensure that no more than one person can control the document at any one time. Do consultees agree?

Paragraph 5.95

This is the first question which pre-supposes some system which holds or records the trade document, rather than it just being an electronic document like this submission or even an email with the relevant content. We note that with the exception of the Australian system (which leaves it to the parties to the contract of carriage to determine what is required) all rely on some sort of approved independently operated system to provide authentication or to record who may deal in accordance with its rules. Once such a system is required, there seems to us no need to employ the concept of possession nor a definition of control independent of the rules of the system in which the document is entered.

Please also refer to our comments relating to the use of "multi-signature" wallets (and similar developing technologies) in our response to Question 11 above.

Consultation Question 13.

8.13 We invite consultees’ views on whether there could be a situation in which multiple parties could have equal claim to “possession” of an electronic trade document in such a way that they would not be “one person” for the purposes of the law.

Paragraph 5.96

Of course this is possible, just as from time to time there is litigation to stop dealings by the person physically holding a trade document on the grounds they are not entitled to deal with it. Such a dispute will be resolved with regard to underlying contractual arrangements or evidence of misappropriation. The use of a system with rules on who can deal facilitates the possibility of arrangements on record for joint control (or different control in specified circumstances) to be a matter of record, if so desired. This would not require a legal definition if it were a matter for system rules and the autonomous decisions of the parties.

Please also refer to our comments relating to the use of "multi-signature" wallets (and similar developing technologies) in our response to Question 11 above.

Consultation Question 14.

8.14 We provisionally propose that, in order for an electronic document to be capable of possession, transfer of the document must transfer control of the document to the transferee, and the transferor must lose control of it as a consequence. Do consultees agree?

Paragraph 5.103

This would be the effect of system rules. However, a system may also allow the system administrator to respond to legal requirements to rectify its records in case of fraud etc. In some cases this could restore control to a transferor (if the holder is a corporate or a nominee of the person on whose instructions a fraudulent/or defrauded transferor should have acted). This can be seen in recent case law involving the use of DLT systems.

We would also refer the Law Commission to the discussion at paragraphs 43 – 46 of the UKJT Legal Statement which underscores an issue with some DLT systems, namely that while control "generally" should be regarded as being vested in the person(s) who hold the private key in relation to a digital asset, it may remain possible for a transferor (who remains on the ledger and prior to the entry of the transferee, for whom a new private key has been generated, is entered on

the ledger) to effect a second transfer of the digital asset – whether innocently, negligently or in fraud of the first transferee. This is why in the Committee's separate response to the Digital Assets Papers (referred to at the start of this response), we consider it essential that appropriate and well-founded priority rules should be established to deal with competing claims to a digital asset resulting from an unauthorised transfer or disposition of the same asset. Where the relevant DLT ledger is accorded the status of a primary record of entitlement to the relevant digital asset (whether through legislation or the rules of the system), we have suggested that the transfer/priority rules relating to the holding and transfer of shares and other registered securities may provide a well-founded and clear legal basis to resolve such priority disputes.

Consultation Question 16.

8.16 We invite consultees' views on whether the ability to retain a copy of an electronic trade document after transfer or other disposal of the electronic trade document could lead to problems in practice.

Paragraph 5.109

This surely depends upon the ease in practice of distinguishing the legally effective electronic document from a mere copy (including a deliberately amended copy intended to mislead the recipient into thinking they have received control of the legally effective document).

Essentially this depends on the quality and robustness of the system used and the access to it, not on whether there is or is not deemed possession of the legally effective document.

Consultation Question 17.

8.17 We invite consultees' views on whether the possessibility of electronic trade documents should depend on any other factors or criteria. If so, please explain the reasons for your additional criteria.

Paragraph 5.111

As indicated above, once the quality of the system of record becomes key, the value of extending the concept of possession to the electronic document becomes doubtful. It does not seem to add anything, while causing confusion if there is any overlap with other systems for assets to which the concept of possession would be relevant if they were not in dematerialised form, but which do not use to concept of possession in relation to the dematerialised asset that replicates the rights that would otherwise arise under or in relation to the instrument when held in physical form.

Consultation Question 18.

8.18 We provisionally propose that:

- (1) the person who is able to control an electronic trade document is the person in possession of it; and
- (2) possession of an electronic trade document is transferred from one person to another when the transferee gains control of that electronic trade document.

Do consultees agree? If not, please explain why not.

Please see our other paper referred to at the start of this one. The concept of deemed possession is novel and the concept of control has been fraught with judicial hesitancy in the field of financial collateral. To the extent that the Law Commission recognise that an independent system of record and/or authentication may be needed or appropriate, reliance on the rules of the system, rather than legal concepts that, based on our experience, seem potentially likely to increase the scope for litigation and decrease legal certainty, seems more suitable to us. Additionally, in such a case, parties are then bound by the rules of the system they have chosen to use for the electronic document, without an overlay of judicial intervention which could include consideration of other factors, such as the agreement between the holder in the system and one or more other parties who may be entitled to direct the holder of record in the system.

Paragraph 5.115

Consultation Question 19.

8.19 We provisionally propose that there is no need to make explicit in legislation that the requirement of intention to possess applies to electronic trade documents. Do consultees agree?

Paragraph 5.129

We think this concept was considered by the courts in somewhat unusual circumstances. We do not think it should have a place in a statutory scheme related to electronic trade documents, whatever form it takes. As we have expressed in our other paper, we have serious reservations about the application of certain complex and nuanced elements of the law relating to possession (such as, the *animus possidendi*) to modern legal and technological systems that are intended to give primacy to the ledger as a primary record of entitlement to or in relation to a particular digital asset.

Consultation Question 20.

8.20 We invite consultees' views on what circumstances there could be a debate about which of one or more parties is in possession of an electronic trade document held on a system of the type envisaged by our proposals.

Paragraph 5.130

See our answers to questions, 11, 12, 13 and 18.

Consultation Question 21.

8.21 We provisionally propose that electronic trade documents should not be subject to an explicit statutory requirement for integrity. Do consultees agree?

Paragraph 6.13

We agree.

Consultation Question 22.

8.22 We provisionally propose not to impose an express statutory reliability requirement. Do consultees agree? Please give reasons.

If consultees disagree:

- (1) When should a party be required to prove that their electronic document is reliable?
- (2) Do consultees think our proposals should include an accreditation process? If so, in what form?

We rather think that this requirement is prudent and would not prevent the use of a variety of systems. The extent to which they are required to be accredited or to operate within a defined regulatory framework is a policy choice for government. What is important is that there should be confidence in the use, safety and integrity of the system by the users.

Consultation Question 23.

8.23 We provisionally propose that there should be a statutory requirement that electronic trade documents must contain the same information as would be required to be contained in a paper equivalent. Do consultees agree?

Paragraph 6.33

Yes.

Consultation Question 24.

8.24 We do not consider there to be a need to introduce an express statutory provision on writing in electronic trade documents, because the law already considers electronic displays to be capable of constituting “writing”. Do consultees agree? Please give reasons.

Paragraph 6.43

Yes, for the reasons stated by the Law Commission.

Consultation Question 25.

8.25 We do not consider there to be a need to introduce an express statutory provision on signing electronic trade documents. Do consultees agree? Please give reasons.

Paragraph 6.49

Yes. We believe that the law in England on electronic signatures in documents which are not deeds is relatively clear. There is also currently no clear advantage in terms of EU recognition in specifying any particular quality of electronic signature. This could, however, change if there were extended international consensus on recognition of certain types of independently verified electronic signatures. Practice in common law jurisdictions does not so far favour that methodology and where there is a commercial advantage, parties can always choose to use those verification processes.

Consultation Question 26.

8.26 We do not consider there to be a need to introduce an express statutory provision on the accessibility of information contained in electronic documents. Do consultees agree? Please give reasons.

Paragraph 6.53

We are inclined to think this is unnecessary, and, if any relevant system is regulated, this issue is likely to be addressed in that context.

Consultation Question 27.

8.27 We provisionally propose that legislation should explicitly allow for indorsement of electronic documents. Do consultees agree? Please give reasons. Paragraph 6.60

We accept the reasons given. This is really concerned with the method of transfer of certain of these documents including a requirement for contemporaneous signature being added to the document by the transferring holder (ie to be part of the information on the document). This would not normally be a requirement of a DLT or other electronic system to effect a transfer, so it is desirable to include an express provision to that effect if, for example, the participants in a particular "system" determine that such e-indorsements would add to the integrity, efficiency or effectiveness of the transfer of ETDs through the system.

Consultation Question 28.

8.28 We seek consultees' views on whether there is any need for electronic trade documents to be capable of being issued in sets.

Paragraph 6.62

There may be a need, but we do not think this requires legislation.

Consultation Question 29.

8.29 We provisionally propose that no further provision is required in legislation to address the following in respect of electronic trade documents:

- (1) timing of delivery;
- (2) timing of transfer;
- (3) rejection; and
- (4) amendment.

Do consultees agree?

Paragraph 6.75

Yes. We note that under existing law electronic time stamps may be issued where required.

Consultation Question 31.

8.31 We seek consultees' views on whether the phrase "so far as practicable" should be included in clause 2(2)(c). If yes, please give examples where such a qualification would be required.

Paragraph 6.80

We would not include these words.

Consultation Question 32.

8.32 We seek consultees' views on what security interests are typically taken over trade

documents at the moment.

#### Paragraph 6.102

Charges created by UK companies under any system of law, not just English law, require registration at Companies Registry in order to be perfected (i.e. so as to be effective against the chargor in insolvency and the general body of its creditors). There are no UK registration requirements regarding foreign companies, including those established in the UK. Without registration, a charge is void on the insolvency of the chargor and will not be enforced in favour of the security taker.

Pledges and liens that depend on physical possession of the item(s) given in security (including documents) are accepted as legally distinct from charges and do not require registration in order to perfect the rights or interest of the pledgee/lienec in the relevant asset.

Security interests created over physical trade documents are mostly short term in nature and in the form of pledges or arise as a result of a lien (particularly in the context of storage of goods in transit), although there will be some longer term more complex trade finance arrangements where a charge may be used and may extend to trade documents within the proposals.

There may be arrangements in relation to bills of exchange and promissory notes which are purely financial in nature and not concerned at all with goods in transit. In those cases, security may be based on endorsement to the financier (or the representative of a group of financiers) and there may or may not be an arrangement relating to the proceeds of the bill or note which includes a charge.

Charges over all the assets of a company will naturally extend to trade documents and will create a floating charge – requiring registration for perfection, if created by an UK company.

There are good policy reasons for pledges, liens and bailments of trade documents not to be registrable – namely their short term nature, the fact that the security taker is the holder of the documents as both documents of title and instruments of transfer (and so there is a minimal "false wealth"/fraud risk) and the well-recognised market practice in relation to their use. In dematerialising trade documents there is value in maintaining the ability of the holder of the dematerialised document to create a security interest, which is not registrable, where the electronic document is held in the relevant system by the taker of security or a person (other than the security giver) acting on its behalf: this is to exclude the "false wealth" concern where assets over which security has been given remain held in the name of the security giver.

This could be done by expressly creating the right to create "virtual" pledges and liens etc over these ETDs, with a clear description of what is required and expressly providing that such rights do not require registration in the UK. This will, however, only cover documents created under English law, but UK companies will also increasingly deal with foreign law dematerialised trade documents, which will not be covered without express language.

It may be more appropriate to simply create an express exemption from registration requirements for UK companies in respect of security given over electronic trade documents whether or not governed by the law of any UK jurisdiction, provided the documents are held in the name of the security taker or its agent (who cannot be the security giver). Other security arrangements should require registration as a charge as currently.

Even then there are difficulties related to the conflict of law rule that requires relevant formalities in the place of the location of a physical moveable are complied with in order to create a valid charge or other security interest. This is acute where the deemed characteristics of a possessory

asset are fully preserved as proposed. Even with a registration approach, it is necessary to either disapply this rule or have a rule that links location to eg the habitual residence of the administrator of the system. This cannot be excluded from consideration, but must be addressed at this stage to create a workable financing situation for trade documents: see further our response to question 38.

We note that this conflict issue related to location was picked up more generally by Barnabas Reynolds in his article "Britain has more than a token solution to offer fintech" in the Telegraph on 12<sup>th</sup> August 2021, which states that the legal problem is "how and where digital assets are owned." He points out: " Under private international law as understood in most countries, the account records provide the anchor, and other legal and regulatory systems should defer to the law of the country where the records are held and allow it to be the sole judge of legal entitlements and regulatory consequences." He suggests , as does work by the UKJT on arbitration of disputes regarding digital assets, that a choice of law and location for a system can determine the relevant legal system, given that DLT systems involve numerous jurisdictions simultaneously. For electronic trade documents (which in customary form are short and formulaic, so unlikely to contain extensive choice of law clauses) clarity on the role of the system used to hold documents is likely to be key.

Dealing with this topic in a clear and comprehensive manner from the outset will be essential to the acceptance of electronic trade documents in financings for UK companies. It will also be essential to the willingness of international businesses more widely to adopt English law solutions for electronic trade finance rather than those of other jurisdictions.

Consultation Question 33.

8.33 We provisionally propose that an electronic trade document should be capable of being the subject of possessory concepts including bailment, conversion, pledges, and liens, and that this should be provided for in legislation. Do consultees agree?

Paragraph 6.110

See our response to question 32. We do not think just stating the principle will be sufficient to avoid litigation, given the duty of insolvency practitioners to collect the assets of failed companies, particularly if the conflict rules are not addressed. We would emphasise, as outlined in our other paper on the financial markets considerations relating to digital assets, that we do not consider it would be appropriate (and would give rise to material legal uncertainty) to extend possessory concepts such as bailment, conversion, pledges and liens to digital assets that have been expressly and deliberately constituted as registered dematerialised assets (on and subject to the laws and rules relating to the issue, holding, transfer, priority and perfection of registered dematerialised assets).

Consultation Question 34.

8.34 We provisionally propose that existing rules and practices can accommodate the discharge, surrender or accomplishment of electronic trade documents, and that no specific legislative provision is needed. Do consultees agree?

Paragraph 6.114

We agree.

Consultation Question 35.

8.35 We provisionally propose that provision should be made to allow for a change of medium for trade documents from electronic to paper, or from paper to electronic. Do consultees agree?

Paragraph 6.125

We believe this would be useful, given that electronic documents will not be accepted in many jurisdictions. Is it necessary to specify that the system can issue the document to the current holder on behalf of the original issuer, with power to sign on their behalf where a signature is needed and specifying that the physical document takes effect for the benefit of the holder to whom it is issued? There would seem to be considerable time difficulty with some documents if intermediate endorsements and physical signatures of all parties were required to be obtained.

Given the law on Bills of Exchange and the long-standing international acceptance of this, we are not entirely clear that this shortcut would be acceptable in other jurisdictions with regard to bills of exchange and promissory notes.

This is an area where the detailed views of operators using these documents need to be taken into account.

Consultation Question 36.

8.36 We seek consultees' views on whether the draft Bill should contain a requirement that the issuer of a trade document must allow the person in possession to change the document's medium.

We think this is a matter for operators of the system to consider. There may be reasons why a physical document which is complete with physical endorsements is essential in some jurisdictions and it may be undesirable that an intermediate holder could cause problems, eg in relation to presentation in the final destination of goods.

Consultation Question 37.

8.37 We seek consultees' views on whether the electronic trade documents that satisfy the requirements of our draft Bill will also satisfy the requirements of the MLETR. To the extent that consultees consider our provisional proposals to be incompatible with the MLETR or other international approaches, please explain this and the consequences to which it could give rise.

Paragraph 6.136

We think it highly desirable that any reform to allow electronic trade documents that is adopted for England (or the UK as a whole) is compatible with the MLETR and is adopted in that context, unless there are very considerable countervailing factors.

We think that as things stand it would be unclear whether the legislation was intended to fall within the MLETR, which would mean that recognition in third countries that have expressly adopted it would have to await both clarification of the UK's position in relation to the MLETR at least as regards England and Wales and then whether this legislation was evidence of implementation. This needs to be considered with the Ministry of Justice.

Consultation Question 38.

8.38 We provisionally propose that the Law Commission should consider the private international law aspects of digital assets, including electronic trade documents, as part of a separate project.

Do consultees agree?

Paragraph 6.148

We do not think that this legislation will work effectively either in England and Wales or abroad, unless the conflict rules specific to electronic trade documents are addressed.

In particular this is because one of the key rules of English conflict of laws requires that security created over a physical asset complies with any relevant formalities (such as registration) in the place where the asset is located at the time of the creation of the security. This as we understand it would apply to any form of security consistent with the general rules cited in the consultation paper, although the case law relates to charges.

It is therefore essential either to disapply the rule for electronic trade documents (so that compliance with the requirements of English domestic law only are required) or to identify their location at each change of holder event. Logically, the location of the system in which the document is held would be suitable (and an improvement on multiple locations depending on the habitual residence of eg the transferring holder), but as we know DLT systems are potentially "located" in multiple jurisdictions though the operation of "nodes" each recording a legitimate and immutable copy of the system's ledger. This comes back to the issue of provisions identifying the characteristics of acceptable systems for holding electronic trade documents which include a deemed location (linked eg to the place of incorporation of the administrator or, the law chosen to govern the system). We are happy to discuss this in more detail.

We appreciate this sounds like the tail wagging the dog, but for this system to work effectively it must support the reliable creation of security from the start and provide a clear, well-founded and enforceable legal basis for the determination of the law that will govern the resolution of any question relating to proprietary issues affecting an ETD.

Consultation Question 39.

8.39 We provisionally propose that the word "issue" describes the process by which a trade document (where relevant) becomes a document of title. Do consultees agree?

Paragraph 6.162

We agree that the word "issue" is appropriate to describe the point at which a trade document becomes legally effective.

Consultation Question 40.

8.40 We provisionally propose that the change of medium of a trade document issued before the Act comes into force should not be permitted. Do consultees agree?

Paragraph 6.165

Yes

Consultation Question 41.

8.41 We provisionally propose that our proposals do not create any additional risk that documents which are not intended to be documentary intangibles will become so by virtue of the draft Bill. Do consultees agree?

Paragraph 6.175

As indicated in answer to earlier questions, our concern is that documents not connected with trade in goods become treated as if they were. As documents in this category are included in non-possessory dematerialisation systems, the availability of a possessory system would cause confusion and considerable legal uncertainty for financial markets that must operate under a legal

framework that supports a "high degree of legal certainty". This is particularly a concern for documents that are technically banker's acceptances or promissory notes (sometimes technically bills of exchange). We think that if these classes of document are included there needs to be consideration of exclusions or limitations – eg limitation on the inclusion of these documents to those issued in payment for goods or exclusion of these documents when issued for other purposes and certainly when issued in relation to financial and money market activities. The views of the Bank of England on this will be important.

Consultation Question 49.

8.49 We provisionally propose that electronic trade documents will reduce the risk of fraud compared to paper trade documents. Do consultees agree?

Certainly this should be the aim and we believe it is achievable, but we think this depends more on legislation covering the systems that may be used to hold dematerialised trade documents than on any provisions in the draft Bill as currently drawn. As expressed in our other paper in response to the Law Commission's Digital Paper Assets and in our response to Question 32 above, we also have a concern as to the risk of fraud under DLT or other electronic systems that (in accordance with their rules or protocols) give their ledgers the status of a primary record of entitlement, but allow for non-transparent (i.e. not reflected in the ledger) transfers or dispositions of rights or interests in or in relation to digital assets recorded in the system (e.g. by way of charge) through, for example, the transfer of control over the private key relating to the asset – without requiring for the public registration of the relevant transfer or disposition.

Consultation Question 50.

8.50 We provisionally propose that electronic trade documents will enhance the transparency of supply chains. Do consultees agree? Please provide examples or evidence if possible.

Paragraph 7.57

We think this would also depend on the rules of the systems used and their interaction with regulation. Depending on those it could be more or less difficult for parties to trace the history of their trade documents.

[Questions omitted]

Consultation Question 55.

8.55 We seek consultees' views on factors that may affect the willingness of financiers of trade transactions to adopt electronic trade documents.

Paragraph 7.78

The ability to take reliably valid security is absolutely key to the willingness of financiers to adopt electronic trade documents. We have outlined our concerns in this regard in answer to earlier questions.

[Questions omitted]

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